

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
JOSEPH AGNONE AND NICOLA NAPPO :
D/B/A/ ANTHONY'S PIZZERIA :
: :
For Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period September 1, 1984 :
through November 30, 1987.

In the Matter of the Petition :
of :
JOSEPH AGNONE AS PARTNER OF : DETERMINATION
ANTHONY'S PIZZERIA :
For Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period September 1, 1984 :
through November 30, 1987.

In the Matter of the Petition :
of :
NICOLA NAPPO AS PARTNER OF :
ANTHONY'S PIZZERIA :
For Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period September 1, 1984 :
through November 30, 1987.

Petitioners, Joseph Agnone and Nicola Nappo d/b/a Anthony's Pizzeria, 721 East Jericho
Turnpike, Huntington, New York 11743, Joseph Agnone as partner of Anthony's Pizzeria, 5
Treehollow Lane, Dix Hills, New York 11746 and Nicola Nappo as partner of Anthony's
Pizzeria, 232 Princess Street, Hicksville, New York 11801, filed petitions for revision of a
determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for

the period September 1, 1984 through November 30, 1987 (File Nos. 807474, 807475 and 807480).

A consolidated hearing was held before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York on August 2, 1990 at 1:15 P.M., with additional evidence and briefs to be submitted by February 4, 1991. Petitioners appeared by Peter R. Newman, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Peter J. Martinelli, Esq., of counsel).

ISSUE

Whether petitioners have established that the audit methodology used by the Division of Taxation was unreasonably inaccurate or that the results of the audit were incorrect.

FINDINGS OF FACT

As the result of a field audit, the Division of Taxation issued two notices of determination and demands for payment of sales and use taxes due, dated July 20, 1988, to petitioner Joseph Agnone & Nicola Nappo d/b/a Anthony's Pizzeria ("Anthony's"). The first notice assessed a sales tax deficiency in the amount of \$73,156.00 for the period September 1, 1984 through November 30, 1987, plus penalty and interest. The second notice, assessed an additional penalty of \$5,551.70 for the period June 1, 1985 through November 30, 1987. The Division issued separate notices of determination to petitioners Nicola Nappo and Joseph Agnone as individuals, assessing identical amounts of tax, penalty and interest for the same periods. The notices explained that as partners Mr. Nappo and Mr. Agnone were individually liable for taxes determined to be due from Anthony's Pizzeria.

Anthony's representative, acting under a valid power of attorney, executed a consent extending the period of limitation for assessment of sales and use taxes for the period September 1, 1984 through February 28, 1985 to June 20, 1988. There is no evidence of other consents having been executed by petitioners. Petitioners raised no issues with regard to the timeliness of the assessments.

Anthony's operated a neighborhood pizza parlor on Long Island. At the outset of this

audit, the Division sent Anthony's an appointment letter in which it specifically requested that Anthony's make available for inspection all of its sales tax records for the period September 1, 1984 "thru present". The date of the letter was July 22, 1987. Among the records specifically requested were: sales invoices, purchase invoices, cash register tapes, journals and ledgers, and exemption certificates.

On the date of the first audit appointment, the auditor met with Mr. Nappo, Mr. Agnone and their accountant. The Division was informed that no books or records were available for any period before December 31, 1985. The accountant had reconstructed Anthony's receipts for the period January 1, 1986 through January 1987 based upon bank statements and purchase invoices given to him by Anthony's partners, but he could not, and would not, vouch for the accuracy of his computations. The accountant provided the Division with income and expense statements for periods after January 1987. Upon being informed that Anthony's did not retain cash register tapes or maintain a daily record of sales, the auditor asked petitioners to begin keeping such records for her use in performing an audit. The auditor asked to see these records several times, directing her requests to Mr. Agnone, Mr. Nappo, Anthony's accountant and Anthony's attorney. They were never presented to her.

Since verifiable records of sales were not available, the auditor attempted to collect information which would enable her to perform a test period markup audit. The audit worksheets show that the auditor had obtained some information regarding purchases from petitioners. There were purchase invoices from two suppliers for the months of April, May and July 1987, transcripts of the income and expense statements prepared by Anthony's accountant, and purchase figures taken from Anthony's Federal income tax return. The auditor considered the ratio between sales and purchases as shown on the Federal return unrealistic. Furthermore, Anthony's own records were too scanty to allow the auditor to determine whether all purchases were reflected in the records she had available. She therefore attempted to verify Anthony's purchases by contacting suppliers. One of the suppliers contacted was identified from purchase invoices supplied by Anthony's, but this supplier refused to cooperate with the Division. The

auditor also contacted businesses in the area known to sell supplies to local pizzerias. This methodology proved unsuccessful because the responses received were incomplete at best. Because it was unable to verify Anthony's purchases through contact with suppliers, and considered Anthony's own records to be unreliable, the Division decided that a markup of purchases audit would not be feasible. While still in the process of attempting to collect information from suppliers, the Division decided to perform an observation test.

The date of the observation test was September 10, 1987, a Thursday. The auditor noted in her workpapers that the weather that day was warm and sunny. Business hours were 11:00 A.M. to 9:30 P.M., and one of two auditors was on the premises during that time.

The auditors listed the items sold by Anthony's, e.g., soda, pizza slices and coffee, and then kept a count of each item sold during the day. The auditors also kept a count of the number of people who entered the pizzeria which turned out to be 268. To determine taxable sales, the auditor applied the appropriate sales prices to the items sold and totalled the results. In this manner, the auditor calculated total sales for the day of \$962.50. On the day of the observation test, Anthony's used a cash register to record sales. The cash register tape showed gross sales for the day of \$1,047.27. The auditor divided this by 1.075 to calculate taxable sales according to Anthony's records of \$974.20 per day. Based on this figure, she computed audited taxable sales per quarterly sales tax period of \$88,652.20 and audited taxable sales for the period September 1, 1984 through November 30, 1987 of \$1,152,476.00. Anthony's reported taxable sales for the same period of \$174,383.00. The auditor subtracted reported taxable sales from audited taxable sales to calculate additional taxable sales of \$978,093.00 with a tax due on that amount of \$73,156.00. These calculations became the basis for the assessments issued.

On January 12, 1988, the auditor met with Mr. Peter R. Newman, petitioners' attorney, to discuss the audit. At that time, the auditor asked for permission to conduct a second observation test, but Mr. Newman refused to agree to this. Mr. Newman showed the auditor amended sales tax returns for the period September 1, 1984 through August 31, 1987, and the auditor transcribed some information shown on those returns. At the time that this audit was

completed, she was unable to verify that these returns had been filed. At hearing she testified that the returns were filed after the close of her audit and that the tax due had been paid. Her transcript of those returns shows that the amount of sales tax paid by Anthony's with its amended filings was approximately \$7,948.45.

The auditor made notes of her meeting with Mr. Newman in the Tax Field Audit Record. These notes contain the following statement: "Requested records til 11/30/87". The notes show that the auditor had no other direct contact with Mr. Newman until after the notices of determination were issued. The Field Audit Report includes a copy of a power of attorney appointing Mr. Newman to represent Anthony's in connection with the Division's audit of sales tax for the period September 1, 1984 through August 31, 1987. The only other date on the power of attorney is the date of notarization of Mr. Agnone's signature which was September 29, 1987.

Petitioners offered no documentary evidence or testimony at the hearing. At the request of their representative, the record was left open to give petitioners an opportunity to submit evidence of seasonal fluctuations in the pizza business and inflationary trends during the audit period and also to submit a memorandum of law. The date agreed upon for petitioners' submission of documents and a memorandum of law passed without their being submitted, and the record was then closed.

SUMMARY OF PETITIONERS' POSITION

It is petitioners' position that the use of a one-day observation test to calculate Anthony's taxable sales for a three-year period is unfair and unreasonable, especially since no adjustments were made by the Division to account for seasonal fluctuations in sales and inflation. Petitioners maintained that a markup of purchases audit should have been employed instead of an observation test.

CONCLUSIONS OF LAW

A. Every person required to collect tax must maintain records sufficient to verify all transactions, in a manner suitable to determine the correct amount of tax due (Tax Law § 1135[a]; 20 NYCRR 533.2[a]). These records must be made available for the Division's inspection upon request (20 NYCRR 533.2[a][2]). Among the records required to be maintained are "records of every sale" and the tax due on that sale (Tax Law § 1135[a]).

Section 1138(a)(1) of the Tax Law states: "If a return required by [article 28] is not filed..., the amount of tax due shall be determined by the commissioner of taxation and finance from such information as may be available. If necessary, the tax may be estimated on the basis of external indices."

In interpreting section 1138(a)(1), this State's courts have clearly, and repeatedly, stated that the Division may not resort to external indices to determine tax due until it has first requested and then examined the taxpayer's books and records for the entire period of the proposed audit (Matter of Adamides v. Chu, 134 AD2d 776, 521 NY2d 826, lv denied 71 NY2d 806; Matter of King Crab Restaurant v. Chu, 134 AD2d 51, 522 NYS2d 978; Matter of Christ Cella v. State Tax Commn., 102 AD2d 352, 477 NYS2d 858; see also, Matter of Max Service Center, Tax Appeals Tribunal, September 29, 1988; Matter of Utopia Service Center, Tax Appeals Tribunal, March 9, 1989). The request for books and records is a necessary first step in any audit because it is only the insufficiency of records which authorizes the Division to use indirect audit methods (Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44, 411 NYS2d 41; see also, Matter of Adamides v. Chu, supra; Matter of King Crab Restaurant v. Chu, supra; Matter of Arvy's Service Station, State Tax Commn., February 27, 1987). Accordingly, the first issue to be addressed here is whether the Division made an adequate request for petitioners' books and records for the entire period of assessment before resorting to an external index to determine the tax due.

The only unequivocal evidence of the Division's request for Anthony's books and records is the Division's appointment letter of July 22, 1987 where the audit period is identified as

September 1, 1984 "thru present" (Finding of Fact "3"). I interpret the quoted phrase to mean the date of the letter. There is, however, other evidence in the record sufficient to establish that the Division did request records of Anthony's sales for periods up to and including November 30, 1987. The auditor requested that Anthony's keep cash register tapes and a daybook during the course of her audit. She made several requests to review these records, but she was never provided with them (Finding of Fact "4"). The auditor's notes indicate that she asked Mr. Newman for books and records for the period up to November 30, 1987 (Finding of Fact "7"). Based on this record, I find that the Division reasonably concluded that adequate books and records were not available for the period through November 30, 1987.

B. I find no other reason to modify the audit results in any way. Petitioners did not make available records of individual sales, such as cash register tapes or guest checks, and, in fact, petitioners do not even claim to have any verifiable records of sales. Where such records do not exist, the Division is required select an audit method reasonably calculated to determine the sales tax due (Tax Law § 1138[a][1]; see, Matter of W. T. Grant Co. v. Joseph, 2 NY2d 196, 206, 159 NYS2d 150, 157, cert denied 355 US 869). The burden is then placed upon the petitioner to prove by clear and convincing evidence that the audit method or the amount of tax assessed was erroneous (Matter of Surface Line Operators Fraternal Org. v. Tully, 85 AD2d 858, 859, 446 NYS2d 451, 453).

A one-day observation test is obviously not designed to bring about a precise determination of tax due, but precision is not required from an audit methodology where the taxpayer's own failure to maintain adequate books and records prevents exactness in calculating the tax liability (see, Matter of Meyer v. State Tax Commn., 61 AD2d 223, 402 NYS2d 74, lv denied 44 NY2d 645, 406 NYS2d 1025). Furthermore, such a methodology has been found reasonable where the taxpayer's records are undeniably inadequate to form the basis of an audit (see, Matter of Meskouris Bros. v. Chu, 139 AD2d 813, 526 NYS2d 679; Matter of Mera Delicatessen, Tax Appeals Tribunal, November 2, 1989; Matter of Gaetano Vendra, Tax Appeals Tribunal, February 9, 1989).

Petitioners' representative suggested that a test period markup audit is a more preferable method of determining tax due. Whether or not this is true, petitioners presented no evidence to rebut the auditor's testimony that an audit based on purchases was not feasible because the Division could not make a reliable determination of petitioners' purchases (Finding of Fact "5"). Furthermore, petitioners failed to present evidence that the observation test yielded unreasonable or incorrect results.

C. As indicated in Finding of Fact "2", it is probable that the notices of determination being contested were issued after the expiration of the three-year period of limitation for assessment of additional sales taxes for periods before June 1, 1985 (Tax Law § 1147[b]). However, the time requirements of section 1147 have been held to constitute a statute of limitations which must be pleaded as an affirmative defense (Matter of Servomation Corp. v. State Tax Commn., 60 AD2d 374, 400 NYS2d 887). As petitioners failed to raise this issue in their petition or at hearing, they must be considered to have waived any claim they may have had in this regard (see, Matter of Convissar v. State Tax Commn., 69 AD2d 929, 415 NYS2d 305, 306 and cases cited therein).

D. The Division conceded that petitioners' tax liability should be reduced by the amount of sales tax paid by petitioners in connection with the filing of their amended sales tax returns. The exact amount of this payment is not in the record; however, the Division's final calculation of tax due from petitioners shall reflect these payments.

E. The petitions of Joseph Agnone and Nicola Nappo d/b/a Anthony's Pizzeria, Joseph Agnone as partner of Anthony's Pizzeria and Nicola Nappo as partner of Anthony's Pizzeria are granted to the extent indicated in Conclusion of Law "D"; the notices of determination and demands for payment of sales and use taxes due, dated July 20, 1988, shall be modified accordingly; and, in all other respects, the petitions are denied.

DATED: Troy, New York

3/21/91
